I.T.L. INDUSTRIES LIMITED

had figures Board 5/77

ANNUAL REPORT 1976

BOARD OF DIRECTORS

C.A. Bell, Q.C.
Robert E. Deane
Peter Hedgewick
Robert Hill
C.W. Leonardi, C.A.
G. Wallace Wood

OFFICERS

Peter Hedgewick, Chairman
Robert E. Deane, President & Chief Executive Officer
J. Robert Ohrling, Treasurer & Corporate Controller
C.A. Bell, Q.C., Secretary
Vivian Maurice, Assistant Secretary

AUDITORS

Coopers & Lybrand, Windsor, Ontario

TRANSFER AGENT AND REGISTRAR

National Trust Company Limited,
Montreal, Toronto, Winnipeg, Calgary, Vancouver

I.T.L. GROUP OF COMPANIES

I.T.L. Industries Limited
Huron Line & Malden Road
P.O. Box 7068
Windsor, Ontario N9C 3Y8

International Tools
P.O. Box 7068
Windsor, Ontario N9C 3Y8

Reflex Division
P.O. Box 7068
Windsor, Ontario N9C 3Y8

I.T.L. Industries, Inc.
P.O. Box 877
Newark, Ohio 43055

Ray-O-Lite Division
P.O. Box 877
Newark, Ohio 43055

Wheatley Manufacturing
2590 Ouellette Avenue
Windsor, Ontario N9A 6L8

Wheatley Manufacturing
963 Martingrove Road
Toronto, Ontario M9W 4V6

Wheatley Economy Die Sets
2375 Dequindre
Hazel Park, Michigan 48030

Wheatley Die Supply
760 Halpern Avenue
Dorval, Montreal, Quebec H9P 1G6

REPORT TO THE SHAREHOLDERS

Net sales for the year ended November 30, 1976 were $14,218,000 compared to $14,742,000 in the prior year. The net loss for the period was $1,889,000 compared to a net loss of $2,353,000 in the prior year.

As indicated in the financial statement, your Company continued to experience difficulties during the 1976 fiscal year to the point where it was necessary for the debenture holders and the bank to inject additional financing to the extent of $750,000. While this support was appreciated, it is obvious to all concerned that it is imperative that the operating performance of the Company be improved.

To this end, at mid-year your Board of Directors appointed a firm of consultants to review the operations of the Company. This review resulted in numerous operational changes which have improved our cash flow. The unaudited financial statements for the first quarter of the fiscal year indicate that the Company is profitable.

One of the major strengths of the Company is its substantial fixed asset base as evidenced by its insurable value as shown in the notes to the financial statements.

The management of the Company has been decentralized by making each Division Manager fully responsible for the complete operation of the division. Corporate expenses have been curtailed.

Effective November 1, 1976, Robert E. Deane was appointed to the position of President and Chief Executive Officer of the Company.

In addition, the Board of Directors wish to thank the employees of the Company for their services and efforts during this most difficult period.

TOOLS DIVISION

The operation of the Tools Division has been improved. The open orders at the present time are at an all-time high level. Production levels are following the order pattern.

WHEATLEY DIVISION

The Wheatley Division's facilities were curtailed during the year with the shutdown and sale of the Toronto manufacturing facility. Orders for the Toronto area are now accepted in the Toronto sales office with the product being manufactured in Windsor and shipped to Toronto on a daily basis.

As a result of the above consolidation, fixed costs, investment in fixed assets, and inventory levels have all been reduced.

Wheatley products can now be priced at a level competitive with other firms in the industry.

REFLEX DIVISION

The technology of the Reflex Division in the manufacturing of reflex lenses is unequaled in the industry. Capitalizing on this base, the division has received orders from the major automotive manufacturers which will improve the volume of business in this division as compared to the previous year.

I.T.L. INDUSTRIES, INC.

U.S. Government has legislated that the majority of pharmaceutical prescriptions sold in the U.S. must be packaged in the child-resistant air-tight vial. I.T.L. holds the patents on its child-resistant air-tight vial. In addition, as a result of this legislation, the number of manufacturers in the business has decreased.

OVERVIEW OF THE OPERATIONS

Your Company has, over the past few years, been through a difficult period. At this time, we see a return to a profitable operation commencing with the first quarter of 1977 and continuing throughout the fiscal period.

On behalf of the Board of Directors

Robert E. Deane

Robert E. Deane
President & Chief Executive Officer

March 31, 1977

I.T.L. INDUSTRIES LIMITED AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS

FOR THE YEAR ENDED NOVEMBER 30, 1976

	1976	1975
SALES	$14,217,751	$14,742,199
COST OF SALES (including selling, general and administrative expenses)	14,399,237	15,382,888
LOSS BEFORE THE FOLLOWING DEDUCTIONS	181,486	640,689
DEPRECIATION	856,692	925,167
AMORTIZATION OF FINANCING COSTS AND PATENTS	24,988	24,994
INTEREST ON LONG-TERM DEBT	533,553	576,283
OTHER INTEREST	278,291	167,830
	1,693,524	1,694,274
LOSS BEFORE PROVISION FOR INCOME TAXES	1,875,010	2,334,963
PROVISION FOR INCOME TAXES		
Current	—	(4,500)
Deferred	13,900	22,500
	13,900	18,000
NET LOSS FOR THE YEAR	$ 1,888,910	$ 2,352,963
LOSS PER COMMON SHARE	$ 1.27	$ 1.56

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

FOR THE YEAR ENDED NOVEMBER 30, 1976

	1976	1975
RETAINED EARNINGS (DEFICIT) — BEGINNING OF YEAR	$(1,914,337)	$ 438,626
Net loss for the year	1,888,910	2,352,963
RETAINED EARNINGS (DEFICIT) — END OF YEAR	$(3,803,247)	$(1,914,337)

I.T.L. INDUSTRIES LIMITED AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED NOVEMBER 30, 1976

	1976	1975
USE OF WORKING CAPITAL		
Net loss for the year	**$1,888,910**	$2,352,963
Add (deduct) items not affecting working capital		
Depreciation	**(856,692)**	(925,167)
Amortization	**(24,988)**	(24,994)
Deferred income taxes	**(13,900)**	(22,500)
Gain on disposal of fixed assets	**201,239**	243,313
Applied to operations	**1,194,569**	1,623,615
Purchase of fixed assets	**308,345**	1,671,101
Reduction of long-term debt	**870,937**	1,308,950
	2,373,851	4,603,666
SOURCE OF WORKING CAPITAL		
Proceeds on disposal of fixed assets	**283,540**	627,851
Proceeds on assumption of long-term debt	**—**	700,634
	283,540	1,328,485
DECREASE IN WORKING CAPITAL	**2,090,311**	3,275,181
WORKING CAPITAL — BEGINNING OF YEAR	**783,150**	4,058,331
WORKING CAPITAL (DEFICIENCY) — END OF YEAR	**$(1,307,161)**	$ 783,150

I.T.L. INDUSTRIES LIMITED AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED NOVEMBER 30, 1976

1. ACCOUNTING POLICIES

The following is a summary of significant accounting policies followed in the preparation of these financial statements. The policies conform with generally accepted accounting principles and have been consistently applied.

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiaries, I.T.L. Industries, Inc. and Wheatley Manufacturing Limited and its subsidiaries. All inter-company transactions have been eliminated.

(b) Currency Translation

United States dollar amounts for current assets and liability items have been translated to Canadian dollar amounts at par.

Fixed assets, accumulated depreciation, other assets, long-term debt and other liabilities have been translated at the rates in effect when the assets were acquired and the debt incurred.

United States dollar amounts included in the statement of earnings have been translated to Canadian dollar amounts at par adjusted to reflect depreciation and amortization charges on historical dollar costs.

(c) Inventories

Inventories, other than tooling jobs-in-process, are stated at the lower of cost and net realizable value with cost being determined principally at standard which approximates first-in, first-out cost.

Tooling jobs-in-process are stated at the lower of accumulated contract costs to November 30 and contract net realizable values.

(d) Depreciation and Amortization

Allowances for depreciation and amortization are provided on a straight-line basis by charges to expense sufficient to write off the cost of the assets over their estimated useful lives. The annual rate used for each class of assets is as follows:

Buildings	2-1/2%
Machinery and equipment	7-1/2 to 10%
Tools and dies	33-1/3%

Maintenance and repairs to all fixed assets are charged to expense as incurred.

(e) Amortization of Financial Expenses, Patents and Licencing Costs

Expenses incurred by the company to obtain long-term financing, patents and licences are being amortized in these financial statements as follows:

Financial expense	10 to 20 years
Patents and licencing costs	17 years

(f) Deferred Income Taxes

Deferred income taxes are provided upon the timing differences between amounts charged for depreciation and amortization of financial expenses for accounting and tax purposes.

2. INVENTORIES

Inventories consist of the following:

	1976	1975
Raw materials	$ 595,692	$ 884,183
Work-in-process	1,297,860	940,950
Finished goods	911,393	1,035,318
	$2,804,945	$2,860,451

3. FIXED ASSETS

The following is a summary of fixed assets and related accumulated depreciation:

	1976			1975
	Cost	Accumulated depreciation	Net Book Value	Net Book Value
Land	$ 219,836	—	$ 219,836	$ 219,836
Buildings	3,164,795	$ 697,647	2,467,148	2,538,635
Machinery and equipment	8,222,493	5,209,415	3,013,078	3,618,512
Tools and dies	976,343	625,633	350,710	301,117
	$12,583,467	$6,532,695	$6,050,772	$6,678,100

Insured value of the company's fixed assets as at November 30, 1976 is $15,900,000.

The net book value of the Amherstburg facility of the Reflex Division of International Tools (1973) Limited has been re-classified as "Other Assets" since the company intends to sell this asset. The carrying value approximates net realizable value.

4. **BANK LOANS AND ADVANCES**

Book debts and inventories have been pledged as security for bank loans and advances, subject to the claims of the demand noteholders as set out in note 8.

5. **INCOME TAXES**

The company's subsidiaries have losses of approximately $5,070,000 available to reduce their future taxable incomes. These losses expire as follows:

	Subsidiaries	
	Canadian	U.S.
1977	—	$ 800,000
1978	—	300,000
1979	—	200,000
1980	$1,190,000	1,050,000
1981	950,000	—
1983	—	580,000
	$2,140,000	$2,930,000

No recognition has been given in these financial statements to future tax benefits that may result from the above losses.

A Canadian subsidiary company has an unrecorded deferred income tax liability of approximately $150,000 ($250,000 in 1975); the liability arose from timing differences between accounting and tax depreciation that occurred prior to 1968; part of these timing differences were reversed in 1976. Depreciation of approximately $230,000 recorded in the accounts of another Canadian subsidiary has not been claimed for tax purposes and is available to reduce future taxable income; no future tax benefit related to this depreciation timing difference has been recognized.

6. **LONG-TERM DEBT**

Long-term debt consists of:	1976	1975
6.20% Series A sinking fund debentures, maturing June 15, 1981	$ 261,000	$ 320,100
6-1/2% Series B sinking fund debentures, maturing December 15, 1981	177,000	213,750
8-1/2% Series C sinking fund debentures, maturing June 15, 1983	772,000	934,900
8% 1969 Series convertible sinking fund debentures, maturing October 1, 1988 (note 7)	3,000,000	3,000,000
8-7/16% A.A.B. loan, repayable $22,200 monthly, maturing June, 1980	1,107,500	1,131,500
10% first mortgage, repayable $4,315 (United States funds) principal and interest monthly, maturing April 1, 1992	405,841	416,825
Lien notes at U.S. prime rate plus 1%, repayable $10,167 (United States funds) principal monthly, maturing 1980	435,270	536,703
Other long-term debt, maturing 1979	216,882	357,788
	6,375,493	6,911,566
Less: Current portion (note 9)	1,157,310	822,446
	$5,218,183	$6,089,120

The debentures are secured by a fixed charge on the fixed assets of Wheatley Manufacturing Limited and a floating charge on the assets of I.T.L. Industries Limited and all subsidiary companies subject to the prior charges of the bank (note 4), of the A.A.B. loan on assets of the Reflex Division of International Tools (1973) Limited and of the holders of the 10% mortgage and lien notes on certain fixed assets of I.T.L. Industries, Inc. The A.A.B. loan is also guaranteed by I.T.L. Industries Limited.

On January 26, 1977, the Department of Industry, Trade and Commerce of the Government of Canada waived its present right of action arising from International Tools (1973) Limited's failure to comply with the repayment terms of its A.A.B. loan agreement. The company is continuing re-negotiation of the terms of this loan.

The payments required in the next five years to meet long-term debt instalments and sinking fund provisions and interest are:

	Long-Term Debt Instalments and Sinking Fund Provisions	Interest
1977	$1,157,310	$475,495
1978	612,596	401,375
1979	611,630	352,891
1980	452,721	310,503
1981	308,402	281,807

7. **CAPITAL STOCK**

COMMON SHARES

Share Purchase Warrants have been issued entitling the holders thereof to purchase 15,000 common shares of the company (subject to certain adjustments) up to June 1, 1978 at a price varying from $18 to $20 per share (subject to certain adjustments) according to the date the warrants are exercised.

Under the terms of the issue of the 8% 1969 Series convertible sinking fund debentures, each $1,000 debenture is convertible into 43-1/2 common shares on or before October 1, 1977, decreasing annually to 33 common shares on or before October 1, 1984.

145,500 shares of the unissued common shares are reserved against conversions of the 1969 Series debentures outstanding at November 30, 1976, and the exercise of the Share Purchase Warrants.

PREFERENCE SHARES

The rights attached to the Series A preference shares require the company to create a reserve for the purchase of these arrears for cancellation. The balance of the reserve at November 30, 1976 was the maximum required amount of $100,000.

Each Series B preference share is convertible into 1.316 common shares on or before June 1, 1977, decreasing annually to 1.250 common shares on or before June 1, 1978.

Dividend shares on the cumulative preference shares amount to $797,940 at November 30, 1976.

8. **DEMAND NOTES**

On November 10, 1976, the debentureholders loaned the company $500,000 on security of demand notes bearing an annual interest rate of 1% over the bank's prime rate. The noteholders have agreed not to call their loans without prior consent of the company's bank before May 2, 1977. These notes are secured by the accounts receivable of the company and its subsidiary companies. The bank and noteholders are entitled to pro rata claims against the first $750,000 of such accounts receivable in accordance with their indebtedness up to a maximum of $250,000 for the bank and $500,000 for the noteholders.

9. **DELAY OF PAYMENTS**

The bank and debentureholders on November 10, 1976 agreed to accept a delay of interest and principal payments due to them up to March 31, 1977. The agreement of the bank is conditional upon the company maintaining accounts receivable in excess of advances by the bank. Payments due at November 30, 1976 but not paid consist of:

Interest	
Bank loans	$139,159
Demand notes	2,900
Debentures	265,388
	407,447
Debenture principal	150,000
	$557,447

10. **STATUTORY INFORMATION**

	1976	1975
(a) Remuneration of directors and senior officers as defined by the Business Corporations Act (Ontario) which includes the five highest paid employees	$210,496	$193,590
(b) Sales by class of business were as follows:		
Contract tools	$ 4,878,027	$ 4,984,276
Standard tools and dies	4,441,386	4,629,375
Contract plastic molded products — automotive	1,322,909	2,567,217
Proprietary plastic molded products	3,575,429	2,561,331
	$14,217,751	$14,742,199

11. **ANTI-INFLATION ACT**

The company is subject to restraint under the Anti-Inflation Act and Regulations on the amount of dividends, excluding arrears on cumulative preference shares, which can be declared or paid during the period from November 30, 1975 to October 13, 1977. It is not anticipated that the company will be in violation of this legislation.

12. **SUBSEQUENT EVENT**

On December 15, 1976, Wheatley Manufacturing Limited sold its Rexdale plant and property for $465,000, resulting in a gain before income taxes of approximately $290,000; related income taxes are estimated to be $70,000.

In accordance with the provisions of the trust deed for the Series A, B and C debentures, the company has remitted the proceeds to the debentureholders.

13. **CONTINGENCIES**

The following contingent liabilities exist at November 30, 1976 in regard to a subsidiary company, International Tools (1973) Limited:

(a) The company is defendant in an action for $750,000. Legal counsel is of the opinion that the company has meritorious defences but should the plaintiff be successful in the action the company's liability would be shared with three co-defendants, and may be offset in part by its product liability insurance.

(b) The U.S. Customs Service has proposed a penalty of $180,000 against the company, its customer General Motors Corporation, and its customs broker John V. Carr & Son, Inc., for an alleged violation of the U.S. customs laws. Legal counsel is unable to advise on the outcome of this matter but intends to file a notice with the U.S. Customs Service that the company relied upon the expert advice of its broker in the transaction under investigation. Management expects that the liability, if any, to the parties in the transaction will be substantially less than the proposed penalty.